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Memorandum for:

The attached is a study concerning cost-of-living adjustments in West European wage contracts. It was requested by Lehmann Li, Office of Policy Development, The White House.

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Central Intelligence Agency

Washington, D.C. 20505

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MEMORANDUM

SUBJECT: Cost-of-Living Adjustments in Western Europe

Over the last two years there has been a sharp movement away from cost-of-living adjustments in eight West European countries where such systems have been widely used. However, the degree and permanence of the changes vary considerably among the countries. In Denmark and Norway, cost-of-living adjustments are unlikely to reappear soon, while in Belgium they will resume this year. Italy's system remains intact but has been made less generous. France is mounting a major effort to abolish its de facto indexing system but, the outcome is far from certain. In most of the other countries, labor likely will seek new cost-of-living adjustments when the current economic crisis eases. 25X1

The main reason for the shift is the same in all the countries: the prolonged recession and its accompanying record levels of unemployment. The changes were initiated mainly by governments, except in Italy where business took the lead. High joblessness undermined labor's ability to resist and in some cases union leaders admitted the need for change. Labor opposition is further restrained in France and Sweden by the reluctance of most unions to undercut policies of leftist governments with which they are basically sympathetic. 25X1

Italy

Italy's wage indexation system (scala mobile) covers all public and private workers who are not self-employed; as of 1978 this amounted to 72 percent of all employed workers. The system was made substantially more generous in a 1975 labor-management accord, which provided quarterly wage adjustments designed to keep the average employee abreast of inflation. All workers get the same lira increase, regardless of pay level, meaning that lower paid workers may be overcompensated for inflation while higher paid employees receive progressively less protection. The system thus has the side effect of compressing the wage structure by narrowing the percentage differential between higher and lower paid workers. 25X1

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A new labor-management accord signed 22 January 1983 revised the scala mobile formula downward and changed the base period. It did not, however, structurally alter the system. The net effect of the new agreement is that the lira amounts of future scala mobile increases will be about 15-18 percent below what they would have been under the old formula. However, the basic elements of the 1975 system, such as the basket of goods on which the cost of living index is based and the quarterly adjustment provision, remain intact.

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It is still unclear to whom the changes apply. The accord was signed by the national government, the leading private industry association (Confindustria), and the three major labor confederations. Employer organizations in some sectors (agriculture, commerce, artisans, credit, merchants) have yet to sign the accord, although most have indicated their willingness to conform to the new system. Moreover, Communist trade union members in Genoa have rejected the new labor-management accord. 25X1

Impetus for change in the scala mobile came from Confindustria. Last June, after two years of stalemated labor-management negotiations, it unilaterally terminated the 1975 labor-management accord on which the scala mobile is based. Other employer organizations, including the biggest association of state-controlled industries, followed suit. The largest party in the governing coalition, the Christian Democrats, in effect endorsed the move, but the Socialists and smaller coalition members at first opposed it. The main opposition to change, however, came from the Communist labor confederation (CGIL) and militant rank and file workers. Persistent world recession, the weakening of Italian firms, and the attendant bleak prospect of rising unemployment were the key factors which diminished labor militancy and unity and led to a labor-management compromise. Most labor spokesmen are now giving priority to job security over income levels.

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France

Explicit indexation has been outlawed since 1958 but an implicit guarantee of purchasing power has been a widespread practice for some years. It is carried out through other mechanisms, such as salary scale revisions that "coincide" with CPI changes. In its January 1982 survey of the French economy, the OECD estimated that the degree of linkage to changes in the CPI is effectively one to one and that it occurs, on average, with a lag of only one quarter. There are no established rules for any of this: collective bargaining is largely decentralized (no wage rounds), and the government's direct role -- in the absence of legislation to the contrary, such as occurred last summer to implement the wage/price freeze -- is limited to the approximately 30 percent of the work force comprising the civil service or employees of the nationalized sector. Of course, the government's "persuasive" powers are formidable, and its recommendations are often followed.

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The minimum wage, which covers about 10 percent of the work force, is an exception to the ban on formal indexation. Increases are mandated whenever the CPI moves upward by more than a small amount and must fully offset the rise in prices. There has also been a pronounced, if only roughly

quantifiable, ripple effect from minimum wage adjustments, as firms try to restore the previous wage hierarchy. In recent years, governments of both right and left have expended a great deal of effort to limit these ripple effects.

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The government's shift toward austerity last summer included an effort to effectively eliminate de facto indexation. In the first instance, the four-month nationwide wage freeze prevented at least one quarterly adjustment for most workers and two such adjustments for some. Beginning in November, the government has tried to institute a new system for wage settlements based on anticipated changes in the CPI. After permitting a 3-percent catchup on 1 November as the freeze expired, the government announced its expectation that wage settlements for 1983 would be limited to 8 percent (the forecast CPI increase) and would cover the entire year rather than the shorter periods that had been customary. The government appears to have had greater success in obtaining 8-percent settlements than full-year contracts, probably because the negotiating parties entertain some doubts about how well the system will work. In its negotiations with civil servants, the government won its full-year contract but threw in a safeguard clause that commits it to "examine" the evolution of its employees' purchasing power at the beginning of 1984.

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The government, concerned about the widening inflation gap between France and its principal trading partners, was the driving force behind the change in wage policy. Management was rather more enthusiastic than labor, but worker resistance has been surprisingly modest. There is considerable grumbling because purchasing power stability has been taken as a given for years, but there has thus far been little in the way of strikes or refusals to sign new contracts under the guidelines. The relatively mild labor reaction is due mainly to economic conditions; unemployment is at record levels and concentrated in heavily unionized industries. Other moderating factors were the fact that a Socialist government instituted the changes and that nearly every labor leader recognized that something had to be done about indexation.

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Belgium

Widespread indexation in the 1970s helped boost the share of wages and salaries in GNP from 49.2 percent in 1970 to 60.7 percent in 1981. Wages in Belgium have been determined on the basis of a national collective bargaining agreement between labor and management, following procedures decreed by the government. On 22 February 1982 wage indexation was temporarily modified by a royal decree issued under special one-year governmental powers requested by the Martens government and authorized by parliament. Under that decree wages and salaries for all workers earning above the minimum were frozen for three months. For the next six months, through December 1982, only wages and salaries equal to or below the minimum wage were indexed to the CPI.

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Wage increases in 1983 are to be calculated using December 1982 as a base for further indexation so that workers cannot recoup their 1982 losses. The changes were brought about by high inflation, a rising budget deficit, and losses in international competitiveness. Strikes and slowdowns called to protest the initial measures were largely unsuccessful, lasting only two weeks and attracting only a small portion of the workforce.

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The Netherlands

In the past a wide array of linking and indexing mechanisms were geared to automatically preserve purchasing power and redistribute income downward -- considered a key goal of the welfare state. However, 100-percent wage indexation was eliminated in 1980, the figure being set at 70 percent for that year. In 1981, when unions and employers failed to reach a national wage agreement, the government limited overall wage growth to 5.5 percent and the holiday bonus to 7.5 percent of annual pay. More recently, economic stagnation, declining natural gas revenues, and rising social welfare costs have raised budget deficits to unsustainable levels and led to grudging acceptance of an incomes policy on the part of both the opposition parties and labor unions. With the unemployment rate likely to reach 17 percent this year, some unions now seem willing to allow further wage restraint in exchange for new job creation efforts. Public sector unions continue to resist austerity proposals, however, and most private sector unions are unwilling to allow more than a temporary elimination of indexing in annual labor
25X1 agreements.

The new Dutch cabinet has accepted Prime Minister Lubbers' plan to reduce the budget deficit by restricting spending, including controversial pay cuts for civil service workers and a reduction in government employment. These measures follow a wage freeze for public sector workers in FY 1981/82 and the linkage of maximum growth in government wages to industrial pay in 1982.

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Ireland

Since FY 1974/75, Irish wages have been determined by tripartite negotiations (unions, employers, government) resulting in a national wage agreement. Since 1979 these agreements have been aimed at keeping pay increases in line with demand management policy. Local bargaining for further increases is allowed within the broad terms of the national agreement. Until negotiations failed to produce an agreement on wages in 1982, pay increases were determined with an eye toward full compensation of wage earners for rises in the CPI, taking into account improvements in productivity and special local conditions. From 1976 to 1978, however, no indexation provisions were included in the national agreement. Recent attempts at wage and budget restraint have met with strong resistance and have contributed to three changes of government in the past year. The current Fine Gael government of Prime Minister FitzGerald is strongly committed to reducing government spending and introducing strict wage measures, especially in the public
25X1 sector.

Sweden

Swedish wage contracts are reached through nationwide bargaining, leading to contracts covering an entire industry. Workers are represented either by the Swedish Confederation of Trade Unions (LO), or by one of several central bargaining organizations. Employers in the private sector are represented by the Swedish Employers Confederation (SAF), while a special bargaining organization negotiates for employers in the public sector. Negotiations for

public and private sector employees take place simultaneously, but the public sector usually bases its settlement on that reached between LO and SAF. Wage negotiations generally begin in December and are concluded in the spring. Contracts can be from one to three years in length. 25X1

The latest contract was signed in the spring of 1981 and expired on 31 December. It gave workers a wage increase of 3.6 percent in 1981 and 3.5 percent in 1982 and allowed for cost-of-living adjustments equal to 65 percent of CPI increases exceeding 8.9 percent in 1981 and 6.5 percent in 1982. 25X1

As of February, wage negotiations have reached an impasse, but a decline in real wages this year appears almost certain. Even the 7-percent increase that labor is seeking probably will fall several points short of the 1983 inflation rate. The relatively restrained union behavior is due mainly to the economic slump and the perceived need to restore Sweden's international competitiveness. An additional moderating factor is the close relationship between labor and the Social Democrats. 25X1

Norway

Formal index clauses in wage settlements were in common use throughout the 1960s and the first half of the 1970s. Since then contracts generally have contained only indirect references to price developments, partly because of government policies aimed at weakening the price-wage link. A cost-of-living clause was briefly restored in the wage agreement signed in the spring of 1981. However, the clause was suspended a few months later after the government imposed a price freeze from August through December. 25X1

Denmark

As part of its austerity package last fall the Schlueter government eliminated the system of wage and benefit indexation. The Minister of Labor later told US Embassy officials that this step was the centerpiece of the government's economic program and that it was not likely to be reversed in the foreseeable future, even if the Social Democrats return to power. The austerity measures were approved despite massive demonstrations mounted by organized labor. In private, however, officials of the main labor confederation admitted that Denmark's poor economic condition requires bitter medicine. 25X1

On 8 February union negotiators agreed to renew the biennial National Wage Contract with relatively modest wage increases; rank and file approval is expected. Except for the lowest paid categories, Danish workers will receive wage increases of only 5 percent in 1983 and 1984 -- implying a real wage decline of 2-3 percent in each year. A few days later public employees tentatively accepted annual wage increases of only 4 percent. 25X1